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FEDERAL COMMUNICATIONS COMMISSION
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Policy and Rules Concerning the
Interstate, Interexchange Marketplace

CC Docket No. 96-61

Implementation of Section 254(g) of the
Communications Act of 1934, as amended

1998 Biennial Regulatory Review –
Review of Customer Premises Equipment
and Enhanced Services Unbundling Rules
in the Interexchange, Exchange Access
and Local Exchange Markets

CC Docket No. 98-183

To: The Commission

REPLY COMMENTS OF NEXT LEVEL COMMUNICATIONS

In its initial comments, Next Level Communications ("NLC") urged the Commission to eliminate its out-dated bundling restrictions and allow service providers to offer bundled packages of video services, high-speed data services, and customer premises equipment ("CPE"). The comments filed in this proceeding emphasize the benefits that consumers will realize if the bundling restrictions are relaxed. In particular, the comments filed by consumers establish that bundling will benefit end users by increasing choice, reducing prices, and encouraging the deployment of advanced technologies and innovative services. NLC, a manufacturer of a residential gateway device that allows consumers to access multiple services such as advanced video, data, and voice services from a common (VDSL) platform, urges the Commission to modify or repeal the bundling restrictions so that consumers may take full advantage of these benefits of bundling.

Some parties argue that bundling restrictions should continue to apply to any dominant service provider. NLC does not believe that, in any market where all bundled services are

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available on a stand-alone basis, such a restriction is called for. However, to the extent that the Commission adopts this view, we urge that it should apply only to packages of CPE and service where the "predominant use" of the bundled CPE is in furtherance of the basic service as to which the provider has market power. As we have suggested, this restriction is itself unnecessary: so long as basic services remain available to all consumers on a stand-alone, nondiscriminatory basis, the Commission can be confident that bundling opportunities will enhance competition for telecommunications products and services, not eliminate it. By removing the out-of-date bundling restrictions and allowing both new and existing service providers to meet the ever-developing demands of consumers for advanced and integrated services where market power is not at issue, the Commission can increase consumer choice and promote the public interest.

I. Major Users And Providers Of Telecommunications Services Agree That Bundling Can Benefit Consumers.

The Commission's proposal to allow the bundling of equipment and services will increase competition among providers, particularly as technology facilitates integrated services and the market for multiple services from a single provider ("multi-use market") grows exponentially. The comments filed in this proceeding establish that the bundling proposal would bring substantial benefits to the consumers of those services. Two of the commenting parties – the American Petroleum Institute ("API") and the Enterprise Networking Technologies Users Association ("ENTUA") – provide the unique perspective of telecommunications end users, and both support the Commission's proposal to relax its bundling restrictions because of the myriad benefits bundling could bring to both business and residential users. NLC, as a manufacturer of equipment that can effectively and efficiently be used by multi-use consumers, urges the Commission to pay special attention to these views in considering the elements of its bundling regulation.

API's and ENTUA's comments highlight three important consumer benefits of bundling, points which mirror the arguments presented by a number of service providers filing in

this proceeding. First, bundling will provide consumers with increased choice from a broader variety of new products, services, and technologies. Consumers will still be able to obtain basic service, enhanced services, and CPE on an individual basis. But consumers will also benefit from a wider array of choices in the marketplace where there are several sources for equipment, including the option to purchase service and equipment as a package from the service provider.¹ And by relaxing its bundling restrictions, the Commission will encourage innovation so that companies such as NLC will develop and deploy new integrated technologies efficiently and effectively. Similarly, from the service providers' perspective, bundling will give carriers the flexibility to tailor their high quality, cutting edge technology and service to a broad spectrum of customers with different needs.² The comments submitted both by service providers and consumers demonstrate that the Commission would promote the public interest by allowing carriers to offer attractive bundles of services and equipment to the customers who want them.

Second, bundling can reduce the initial costs of new technology until sufficient demand for it develops, thereby driving down prices for equipment and services to competitive levels. As noted in several parties' comments, the Commission has seen in the context of cellular telephony the benefits of allowing providers of a new technology to offer service in conjunction with the equipment needed to take full advantage of the service.³ Clearly, bundling helped to create widespread acceptance of and demand for cellular technology. By allowing bundling of CPE and

¹ See *Implementation of Section 304 of the Telecommunications Act of 1996; Commercial Availability of Navigation Devices*, Report and Order, CS Docket No. 97-80, FCC 86-116, at ¶ 95 (adopted June 11, 1998) ("*Navigation Devices Order*"); Comments of API, at ii (one significant consumer benefit of bundling is the "flexibility to choose from new services and technologies").

² See, e.g., Comments of GTE, at 10; Comments of BellSouth, at 11; Comments of Ameritech, at 14; see also *Navigation Devices Order*, at ¶ 89 (noting that narrowly tailored anti-subsidy rule "permits new entrants to react quickly to a changing marketplace and provide innovative service offerings to consumers quickly and effectively").

³ See, e.g., Comments of BellSouth, at 6-7; Comments of SBC Communications, at 3-4; Comments of Ameritech, at 8-9; Comments of Bell Atlantic, at 10-12; Comments of U S West, at 7; see also *Navigation Devices Order*, at ¶ 87, 94 (noting positive impact of bundling equipment and service on growth in DBS and cellular subscribership).

other telecommunications services, the Commission will help to ensure that today's consumers similarly will reap the benefits of future technological innovations without having to bear the substantial up-front costs for new equipment. This benefit is especially critical as new, multi-use products and services are being introduced because, as the Commission has recognized, the high cost of CPE is the single greatest deterrent to consumer acceptance of a new technology or service.⁴ For this reason alone, relaxing bundling restrictions is one simple regulatory step the Commission can take to stimulate development and nationwide deployment of advanced services, consistent with the mandate in Section 706 of the Telecommunications Act of 1996.

Bundling can help reduce consumer prices in another way as well. In a competitive market, a carrier who can realize cost savings from economies of scale and other efficiencies as a result of bundling will pass those savings along to customers in the form of lower prices. Consumers can benefit economically when a large carrier is able to negotiate volume discounts from equipment providers, and thereby pass along those savings.⁵ The current bundling restrictions not only limit the available cost savings from combination service and CPE offerings but may actually impose additional costs on consumers, such as transaction costs arising from negotiating individual basic service, enhanced service, and CPE contracts.⁶

Third, in many circumstances business users and individual consumers may prefer to obtain equipment and services from a single provider. As API suggests, many business users would prefer to purchase all of their telecommunications and data services, and corresponding equipment,

⁴ See *Bundling of Cellular Customer Premises Equipment and Cellular Service*, Report and Order, 7 FCC Rcd. 4028, 4030 (1992); see also Comments of BellSouth, at 11.

⁵ See Comments of ENTUA, at 2; see also Comments of MCI WorldCom, at 9 (suggesting existing bundling restrictions prevent carriers from passing savings from packaged offering on to customers); Comments of U S West, at 7 (discussing "package discount" approach).

⁶ See Comments of API, at 6.

from a single carrier or systems integrator rather than to manage multiple vendors.⁷ Individual customers want similar "one stop shopping" opportunities.⁸ By relaxing its bundling restrictions, the Commission will give all service providers the chance to meet the growing demand for integrated service offerings, and provide customers with the full array of benefits from one-stop shopping – including full-service customer care from a single contact, a single bill for multiple services, increased choice, and lower prices. NLC's residential gateway device is one example of how an innovative technology could be used by a single carrier, unfettered by the Commission's current bundling prohibitions, to offer a multi-use service and meet consumers' video, high speed data, Internet, and voice service needs from a single platform.

NLC agrees with the commenting parties who have suggested that, to ensure that all Americans have access to advanced telecommunications services, providers must have adequate flexibility to meet market demand. More importantly, however, new technologies and services must be made available to consumers economically and efficiently, for no matter how attractive a new product may be, there will be no demand for it if the initial price is prohibitively high. By allowing bundling, the Commission can meet its statutory obligation to ensure that innovative services are developed and offered to the public on a cost-effective and efficient basis.

II. The Commission Should Permit Bundling Of Services And Equipment Where The Service Provider Is Nondominant Or Where The "Predominant Use" Of The Bundle Is For Nondominant Services.

The provision of bundled telecommunications equipment and services will increase consumer choice, speed the deployment of advanced services to the public, and pose no serious threat to competition in the relevant markets. A vast majority of the commenting parties agree that

⁷ See Comments of API, at 4-5 ("Perhaps the most significant benefit of bundling is the ability of customers, large and small, to deploy new technology and look to the carrier, systems integrator or ISP to manage both the CPE and the service.").

⁸ See, e.g., Comments of Bell Atlantic, at 14; Comments of SBC Communications, at 7-8.

at least all nondominant service providers should be permitted to bundle equipment and services.⁹ Plainly, because nondominant service providers by definition lack market power, they cannot impede competition in the robust markets for CPE and advanced services by offering a bundled option. Instead, these market participants will provide a new service option for customers, thereby promoting competition.

NLC believes that dominant carriers also should be allowed to bundle products and advanced services with basic service to compete in the multi-use market. So long as basic voice services are available to all consumers on a stand-alone, nondiscriminatory basis and subject to price cap regulations, the Commission can be confident that bundling opportunities will actually enhance competition for telecommunications products and services, not eliminate it. The Commission should thus allow bundling to encourage facilities-based competition in the offering of integrated service packages, because while the trend in telecommunications is toward integrated service offerings, the only current providers of multi-use services are dominant cable systems.¹⁰ NLC's product was designed to provide consumers with the option of receiving video, data, Internet, and voice services from a single VDSL platform in the home. By allowing the ILECs to offer NLC's and similar devices in conjunction with video and high-speed data services, the Commission will give multi-use consumers the opportunity to choose from two competing integrated service providers.¹¹ It is, we suggest, grossly unfair, and a distortion of the marketplace, for the

⁹ See, e.g., Comments of CompTel, at 2, 6; Comments of KMC Telecom, Inc., at 2-3; Comments of Sprint Corp., at 3-4; Comments of AT&T Corp., at 16.

¹⁰ See *Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, Notice of Inquiry, CC Docket No. 98-146, FCC 98-187, at ¶ 39 (adopted Aug. 6, 1998).

¹¹ The Commission has previously concluded that, where an incumbent service provider faces effective competition, regulations preventing equipment subsidies are no longer necessary. See *Navigation Devices Order*, at ¶ 90. By allowing bundling of multi-use equipment and services, the Commission will encourage robust competition between two incumbent providers – cable providers and the ILECs – in addition to new entrants to the benefit of consumers who will see increased choice and lower prices.

Commission to permit cable operators to deploy multi-use CPE and services, but deny that same opportunity to the ILECs. The Commission must not let its rules and policies determine marketplace winners and losers.

Several commenting parties have expressed concerns that bundling will enable the ILECs to exert dominance over basic voice service to influence competition in the CPE and advanced services markets. We think that concern is misplaced. However, to the extent that the Commission embraces such a view, allowing the ILECs to bundle multi-use CPE with integrated service offerings is nevertheless consistent with the widely-supported view that only nondominant carriers should be permitted to bundle.

Several reasons support this conclusion. (1) No ILEC dominates the robustly competitive CPE, data services, or video services markets. These markets are not in danger of ILEC dominance. (2) An ILEC's ability to influence these competitive markets, despite its dominant position in the market for basic voice services, is severely limited in today's telecommunications industry. Specifically, price cap regulation limits the incentive and ability of ILECs to subsidize the price of CPE by raising basic telephone rates. (3) Section 251's resale requirement further limits the ability of ILECs to add costs on to basic telephone service, because any ILEC which raises basic service rates simply invites new competitors to enter the market for basic voice service as a reseller.¹² With no ability or incentive to leverage their dominant position over basic services in the competitive CPE and advanced services markets, the ILECs will simply be another choice for multi-use consumers. And because the ILECs will continue to provide local telephone service on a nondiscriminatory, stand-alone basis, this solution is Pareto-optimal – while no consumer will be worse off, many consumers will be better off.¹³ In this context, the

¹² See, e.g., Comments of BellSouth, at 7.

¹³ Both API and ENTUA noted that bundling will not preclude the provision of basic transmission services, for customers will continue to demand it: "While bundling may offer customers cost-effective alternatives, it

Commission's decision to relax the bundling restrictions will lead to pro-competitive pricing, expanded choice for consumers, and the introduction of innovative products and services.¹⁴

If it nonetheless concludes that some level of bundling regulation is still necessary, NLC urges the Commission, in the context of multi-use CPE and its accompanying services, to adopt a rule that permits bundling of CPE and a range of telecommunications services when the *predominant use* of the CPE is for services in which the carrier is nondominant. That is, where the predominant use of a CPE device is for services other than basic voice services and the carrier is a nondominant provider of those services, the Commission should have a presumptive rule that permits a bundled offering of the multi-use CPE and services. By adopting this simple predominant use test, the Commission could promote competition for advanced services by allowing the ILECs to participate in the multi-use market while allaying concerns that bundling by the ILECs would harm consumers of basic telephone service.

This "predominant use" test could be implemented in one of a number of possible ways to ensure that the bundling of service with CPE will not impede but will enhance competition by increasing customer choice and thereby serving the public interest. For example, the Commission could allow the ILECs to bundle equipment and services where a majority of the services provided (*i.e.*, two or more) are services in which the ILEC is not dominant. Thus, for example, an ILEC using NLC's residential gateway to compete in the multi-use market could offer video, high-speed data, and voice services. Because the ILEC is not dominant in two of those

will not be the only alternative If one carrier does not offer a customer the right set of products and services, the customer will simply go to a carrier that does, or continue to purchase products and services separately." Comments of ENTUA, at 2; *cf.* Comments of API, at 11 ("A la carte' telecommunications services must remain available."); *see also* Comments of BellSouth, at 6. NLC agrees that providers should offer services both on a bundled and stand-alone basis.

¹⁴ NLC agrees that price bundling of products and services will create a package discount for consumers who will still have the service-only option available on a stand-alone basis. Price bundling is not equivalent to tying; where charges are separately stated, there should be no concern about anti-competitive behavior. *See Navigation Devices Order*, at ¶ 87-90; *see also* Comments of GTE, at 12-15.

services – video and high-speed data – the predominant use of the NLC device would be for nondominant services. The Commission should therefore allow an ILEC to bundle video and data services and CPE with basic voice service in this context to compete in the multi-use market and meet the demands of customers. This test, based solely on the number and ratio of services provided, would be the simplest for the Commission to administer and enforce.

Alternatively, the Commission could consider the needs and demands of the customers the bundled package is designed to serve. Again, in the case of NLC's residential gateway device, the extra expense of the device alone will most likely deter those customers who want only basic voice services from purchasing it. Instead, the device is designed to provide customers with access to multiple, advanced services – including video and high speed data – from a single platform; the market for this device and the accompanying service is customers who are primarily interested in the advanced service capabilities. The Commission could reasonably presume, therefore, that the NLC device would be used predominantly for these advanced services, and the capability for basic voice would be an incidental benefit of the packaged offering. In that context, where multiple services are being offered, the Commission should allow the ILECs to provide this equipment and service on a bundled basis.

Finally, the Commission could consider the ratio of bandwidth used by each service to determine the predominant use. Under this test, where a majority of the service's bandwidth is used not for basic voice service but for competitive services such as video and high-speed data – a likely outcome for most multi-use consumers – the predominant use of the CPE would be for nondominant services and the ILECs could bundle.

Whichever analytic framework it adopted, the predominant use test would allow the Commission – and consumers – to benefit from the increased competition the ILECs will bring to the multi-use market. Where the ILEC is bundling CPE and services and the predominant use is


other than basic voice service, the Commission should determine that the ILEC posed no serious threat to competition for advanced telecommunications services or equipment. This outcome would help promote the rapid development and deployment of advanced services at competitive prices, and thereby promote the public interest.

CONCLUSION

For the reasons stated herein, NLC urges the Commission to remove its out-of-date bundling restrictions and allow telecommunications service providers to bundle service with CPE, at least to the extent the provider is nondominant in the service predominantly used by consumers of such a bundled offering.

Respectfully submitted,

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